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SENSITIVE
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DEPT FOR WHA/CEN, WHA/EPSC, WHA/PPC AND EEB
PLEASE PASS TO USTR DOLIVER/AMALITO
PLEASE PASS TO TREASURY SGRAY
MANAGUA FOR DAVID KRZYDA: PLEASE PASS TO DAS BASTIAN AND DAS ONEILL

E.O. 12958: N/A
TAGS: CS ECON ETRD PGOV PREL
SUBJECT: SCENESETTER FOR COMMERCE DAS WALTER BASTIAN'S AND TREASURY DAS BRIAN O'NEILL'S TRIP TO COSTA RICA

REF: A. SAN JOSE 410
¶B. 07 SAN JOSE 1926

¶1. (SBU) SUMMARY: Embassy San Jose warmly welcomes Commerce DAS Walter Bastian and Treasury DAS Brian O'Neill. Both visit Costa Rica as the effort to implement CAFTA progresses through the final stages of modifying Costa Rican laws to conform to commitments made under CAFTA. The Arias administration remains deeply committed to CAFTA, and is slowly making progress. The government's pro-CAFTA coalition remains fragile. Eight of 13 CAFTA-related bills have been completed; five others remain in progress, including those covering controversial intellectual property (IP) and insurance issues. Apart from the CAFTA debate, the Costa Rican economy continues to post positive figures: foreign direct investment (FDI) remains high, tourism numbers have been stable or increasing, and exports have been growing (now exceeding USD 8 billion). Also in the backdrop of the all-consuming CAFTA saga are positive reforms underway within the Ministry of Finance. Treasury's Office of Technical Assistance (OTA) programs have contributed to the GOCR increase in tax collections (36 percent in 2007) and an increasingly more sophisticated approach to budgeting. END SUMMARY.

THE CAFTA SCORECARD

¶2. (U) As of May 27, the national assembly (Asamblea) had completed over half the CAFTA legislation (eight of 13). A ninth bill (on IPR reforms) was bounced by the Supreme Court for constitutional questions (see para 5 below). The four remaining bills (on modernizing telecommunications, opening the insurance market, making additional IP changes, and ratification of various standing CAFTA amendments) are in varying stages of action:

COMPLETED BY ASAMBLEA:

Signed into law:	6
Pending signature:	2

WORKS IN PROGRESS AT THE ASAMBLEA:

Returned by Supreme Court:	1 (Asamblea to correct and vote again)
Under debate:	4
TOTAL	13

THE NEVER ENDING CAFTA CHALLENGES

¶3. (SBU) The Asamblea made more progress on CAFTA legislation in the four months from November 2007-February 2008 than its predecessor had in the previous four years, but momentum dissipated after the EIF extension was granted. The leaders of the 38-seat pro-CAFTA

coalition well understand the need to keep moving, but have found this challenging.

¶4. (SBU) The principal challenge is maintaining and managing the government-led coalition of 38 members (the G38). This is important because a two-thirds majority (precisely 38) is needed to form a quorum, to set rules, and to manage most legislation. Several weeks ago, Christian Unity Party (PUSC) member Bienvenido Venegas, tried to parlay his vote into a political trade for more attention and resources from the central government for his home district (Puntarenas). Though the GOCR cooperated to a point, Venegas's support has remained elusive. Now, the Libertarian Movement (ML) party is challenging the GOCR by delaying action on legislation. ML has not cooperated with the G38 to grant fast track authority -- needed in order to meet the October deadline -- to the remaining IP bill and a bill comprised of CAFTA's amendments. The current impasse prompted Foreign Trade Minister Marco Vinicio Ruiz to publicly comment on the inaction and state his deep concerns that the inaction "is counter to the interests of the nation and achieving FTA approval prior to the October 1 deadline." Privately, COMEX officials describe a frustrated ML party that desires a higher profile for its cooperation with the GOCR on CAFTA but feels short-shrifted. Also, ML may recognize that its ultimate party fortunes are limited and the current situation best defines a moment of pivotal power -- and one to exploit -- for the party.

¶5. (SBU) An ongoing challenge for concluding the CAFTA deal is the Supreme Court, specifically the Constitutional Chamber (Sala IV), which reviews most legislation between the required first and second votes of the Asamblea. The opposition has ensured that all CAFTA bills are reviewed by the Sala IV, delaying the legislative process, but only one bill has been bounced for corrections to date. COMEX and USTR recently met in Costa Rica and discussed changes to the returned IP bill. Progress was made but discussions between the two parties will continue the first week of June in Washington. The Asamblea is to begin action on these corrections as soon as COMEX completes its modifications to the IP bill in consultation with USTR.

¶6. (SBU) Political distractions constitute another challenge. A special committee has been taking testimony on allegations that the Colombian FARC had ties to some political figures, including legislators, in Costa Rica. To date there have been no significant revelations. Another new focus has been the Arias Administration's decision to propose two major extraordinary budget items to reinforce public security in the country and address the issue of food security.

¶7. (SBU) Although the political situation may seem totally consumed by the CAFTA debate, there are horizons beyond CAFTA which pose still another challenge: changing post-CAFTA political alliances. Portions of the Arias Administration's likely post-CAFTA agenda are attractive to the current opposition party, Citizens Action Party (PAC), and anathema to some members of the current CAFTA coalition (G38). For example, the Arias Administration has long advocated an increase in taxes in order to invest in better government and is currently promoting an extraordinary budget of about $88 million to promote food production and subsidize food consumption. It appears likely that the five ML legislators will oppose significant aspects of these proposals, although at the moment the ML are quasi-members of the G38. PAC, on the other hand, promotes state-orientated solutions and is likely to support the administration's post-CAFTA proposals to some degree. The danger for the GOCR lies in the transition period when the G38 must be maintained in the face of potential political re-alignment.

A COMMITMENT, YES. . .BUT WITH A CAVEAT?

¶8. (SBU) Despite these challenges, the Arias Administration remains committed to completing the legislation and implementing CAFTA. President Arias (and by implication, his pushing to complete CAFTA) remains popular. He received a 50 percent good or very good rating in a UNIMER poll released March 24 with the lowest negative rating (14 percent) since taking office. The public and most political parties are tired of the protracted CAFTA debate and want to close

this chapter and move on to other important issues on the horizon.

¶9. (SBU) The GOCR claims to understand that the extension to October 1 was a one-time exception. Yet, we still sense the hidden expectation by GOCR that intractable aspects of the remaining legislation, for example, IP or insurance, might be resolved through last-minute, high-level political bargaining. This is an unrealistic expectation on the part of GOCR since USTR is obligated by its Congressional mandate to implement CAFTA as negotiated and ratified. In his April visit, AUSTR Eissenstat clearly defined USTR's mandate in ensuring that the new laws and regulations are CAFTA compliant (Ref A).

THE NEAR TERM SIGNIFICANCE OF CAFTA

¶10. (U) Without CAFTA, the textile and the tuna sectors are at risk due to the short-run possibility of the loss of Caribbean Basin Trade Promotion Act (CBTPA) trade preferences on October 1 and the long-run risk that Costa Rica will not have permanent, tariff-free access to the U.S. market. For Costa Rica, both risks would portend a competitive disadvantage with its CAFTA neighbors. Business leaders predict 20,000 jobs in the tuna and textile sectors are at stake.

¶11. (U) In the intensely competitive textile industry, buyers want price certainty which Costa Rican companies currently cannot provide. Indicative of the uncertainty, the industry contracted from $730 million in 2002 to $557 million in 2006. The Costa Rican textile industry is heavily reliant on the U.S. market and the preferential treatment it receives under the CBTPA (Ref B). The U.S. accounted for 86 percent of its total textile exports in 2006 and CBTPA lowers the U.S. tariff from 18 percent to zero for most textile products. Thus, without an implemented CAFTA, industry uncertainty has reached critical levels as producers openly talk about moving production outside of Costa Rica.

ARE THERE OTHER ECONOMIC ISSUES?

¶12. (U) In spite of the anticipation of a downturn, the Costa Rican economy continues to post positive economic indicators. The economy registered 6.8 percent growth in 2007 and is projected to grow by 3.8 percent in 2008. Other highlights include:

- FDI remains high. From 2000 to 2007, FDI grew from $409 million to an estimated $1,885 million in 2007. The U.S. contributed roughly 60 percent of FDI in recent years, while the European Community contributed roughly 15 percent.

- Tourism numbers have been stable or increasing. Annual tourist visits to Costa Rica doubled in the ten year period from 1998 to 2007 from 943,000 to 1,900,000 (estimated) in 2007. For the first quarter of 2008, the media reported a 17 percent increase in visits.

- Export totals have been growing. Costa Rica's exports totaled $8.2 billion in 2006. Costa Rica's economy is relatively open to world trade, with exports accounting for 37 percent of GDP in that year. While the traditional agricultural exports of bananas, coffee, sugar and beef are still the backbone of export trade, a variety of industrial and specialized agricultural products have broadened export trade in recent years.

¶13. (U) On fiscal affairs, the Finance Minister, Guillermo Zuniga, and the Central Bank President, Francisco de Paula Gutierrez, demonstrate prudent management of the economy and a commitment to reform. In 2007, the GOCR experienced its first fiscal surplus in 50 years. Plus, the Finance Ministry (the Hacienda) has initiated several new reforms through the assistance of Treasury's OTA. Problematic is the lack of a terrorist finance law in Costa Rica -- one of many bills in the queue behind CAFTA legislation and key to Costa Rica's future participation in the Egmont Group -- and the lack of regulatory oversight of international transactions with

specific regard to money laundering.

¶14. (U) Currently, the OTA operates three programs in Costa Rica of which two -- tax administration and budget -- are well underway and a third, debt management, just launched in February 2008. Both of the established OTA programs have contributed to instituting reforms. All three are summarized below:

- The OTA's tax administration project started in spring of 2005. The OTA interacted mainly with the Internal Revenue Directorate, but has also engaged at the Ministerial level and in Customs Administration. The project has primarily focused on improving planning and management and technical and management assistance which resulted in the improvement of collections (up 36 percent in 2007) and audit and taxpayer assistance operations. At the Ministry level, work is underway to assist the implementation of an Internal Affairs organization through which to investigate allegations of misconduct and corruption by Ministry officials. Finally, the OTA will provide an independent source of advice and managerial monitoring for a major private initiative to modernize the technology infrastructure of tax administration. The OTA project is scheduled to conclude in the fall of 2008.

- Finance Minister Zuniga requested OTA technical assistance in the areas of budget policy and management. Supported by Embassy San Jose and commencing in December 2006, the OTA's work has resulted in key reforms, including the implementation of a medium term budget forecast for the GOCR. The budget project also improved the quality and quantity of information available to decision-makers and constituents regarding the effectiveness of GOCR programs in utilizing budget resources to meet Government objectives. The OTA has provided support in the areas of budget execution, audit, and control. The budget policy and management technical assistance program is scheduled to conclude in late-2008.

- The OTA and the Hacienda launched the Government Debt Issuance and Management Assistance (GDIM) project February 2008. The project will provide technical assistance in debt management, focusing on staff capacity building; risk analysis and management; cash flow forecasting; debt sustainability; domestic market development (institutional and retail) for government and central bank obligations; and fiscal/monetary policy and operations coordination. The initial work has focused on improving the secondary market for government securities since Costa Rican wholesale financial markets are virtually non-existent. This effort will also support the Central Bank as it makes the difficult transition to a more flexible exchange-rate and an inflation-targeting regime which will require the creation of new markets for managing system liquidity.

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